# No. 13,025

IN THE

# United States Court of Appeals

## For the Ninth Circuit

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E. R. CRAIN and FINTON J. PHELAN, JR., on Behalf of Themselves and Other Persons Similarly Situated,
*Appellants,*

vs.

THE GOVERNMENT OF GUAM,
*Appellee.*

**Appeal from the District Court of Guam, Territory of Guam.**

## APPELLANTS' REPLY BRIEF.

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## APPELLANTS' REPLY BRIEF.

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### I. APPELLANT'S ANSWER TO APPELLEE'S ARGUMENT ON POINT 2.

A. The appellee in his brief at page 6, takes exception to the amount of space given by the appellant in his original brief to the question of sovereignty. The trial Court has made sovereignty an issue by holding that the Government of Guam was immuned from suit on the ancient theory "The king can do no wrong". By such a decision, the appellant was forced to show a differentiation between the status of the Government of Guam and that of other possessions

of the United States, who had some similarity. But the appellee mistakes our meaning when we state that this is a matter which has never been subjected to judicial scrutiny. The status of Guam has not as yet been determined by the Courts. It is a new entity established as of July 1, 1950. The only case quoted in Title 48, U. S. Code Annotated, Chapter 10, 1951 Annotations, relative to this problem is the within case. As will be shown hereafter by appellant, there are many differences between the Island of Guam and other territories and possessions cited by the appellee.

It is interesting to note, for example, that in the 1949 and 1950 budgets of the United States Government, no provision was made for the Island of Guam. The Navy administered the possession and had certain funds set aside for Naval shore establishments. (1950 U. S. Government Budget, Navy Department, Bureau of Yards and Docks, page 841.) After the passage of the Organic Act of Guam, the 1951 budget, however, allotted funds to the Department of Interior with the following statements at page 889 under the section on territories and island possessions:

> "GUAM. Effective July 1, 1950, the administration of the Island of Guam will be transferred from the Department of the Navy to the Department of Interior. This activity provides for the salary of the Governor, the per diem for the legislators, the salary of the Chief Justice, and the expenses of the office of the Governor and the Supreme Court. Guam does not presently have a sufficiently developed economy to support the completely governmental services through local

revenues. A grant is therefore provided for the support of services essential to public health, safety and welfare."

This was an official publication of the United States Government. It has no legal effect but is certainly evidence of the lack of certain aspects of sovereignty as previously discussed by the appellant.

On page 7, the appellee states "therefore, lengthy definitions and discussions of the term sovereign are not in point. They do not resolve the issue nor assist its resolution." We submit that the Government of Guam has made an issue of sovereignty but agree that the real problem here is that of construing a statute of the United States. The Government of Guam through edicts of their Governor (a federal employee of the United States) has decreed that a certain system of taxation exists on Guam. The Governor of Guam has interpreted Section 31 of the Organic Act of Guam so as to require payment into their treasury of income taxes similar to that in existence in the United States. They have based their contentions upon a certain information bulletin of the Treasury Department of the United States, to wit, I. T. 4046, 1951-6-13559, construing Section 251 of the Internal Revenue Code. That bulletin states:

"Inasmuch as Guam is not excepted in the provisions of Section 251 of the Code (Internal Revenue Code of the United States) the bureau is of the opinion that it should be considered a possession of the United States for Federal income tax purposes, regardless of its classification as an un-

> incorporated territory by the Organic Act of Guam. It follows, therefore, that a domestic corporation would satisfy the condition set forth in Section 251a of the Code, is taxable for Federal income tax purposes only with respect to income derived from sources within the United States.
>
> "The effect of Section 31 of the Organic Act of Guam is to set up a separate income tax for Guam which is a duplicate of the Federal income tax."

One agency of the United States Government, the Internal Revenue Department, has construed a statute without the benefit of the United States Courts. Another agency of the United States Government, to wit, the Department of Interior acting through the Governor of Guam, is attempting to put into effect the construction of its fellow agency. We submit that the real issue is one which has not yet been determined and has not been subjected to judicial scrutiny, i.e., can an agency or employee of the United States construe statutes of the United States and by such construction oust the Courts of the United States from jurisdiction to determine the correctness of their decision? We submit, however, that in order to answer that question there must be a determination made as to whether or not the rule of sovereignty does apply. In this connection it should be noted again that the Treasury Department states "regardless of the classification of Guam under the Organic Act," thereby clearly showing a difference between Guam and other possessions.

B. Appellee states at page 7, "they seem to contend that as one ascends from some point in the hierarchy, immunity to suit applies, in that any government below such point has no immunity to sue." The appellant has not made any claim as to such a hierarchy. Appellant has merely pointed out that there are strong and specific distinctions between the other territories cited and that of the Island of Guam. It should be noted that Guam and Guam alone reports to an appointive officer. (Organic Act Section 19.) On the other hand, the other territories have been accorded by Congress the dignity of reporting directly to the President and through him to Congress. We believe that this is a substantial matter and not to be lightly dismissed. In actual practice, the Government of Guam does what the Secretary of the Interior directs it to do and it functions similarly to any other subordinate agency of that department. Appellee quotes in his brief, pages 8 and 9, the specific portions of the Organic Act of Alaska, Puerto Rico and Guam, which shows such a distinction but the appellee fails to notice the specific wording of the statute.

Appellee also fails to recognize that we are questioning the construction of a statute of the United States pertaining to certain taxes. It should be noted that the other territories involved, to wit, the Virgin Islands and Puerto Rico, were specifically excluded from Section 251d of the Internal Revenue Code of the United States at the same time a system of taxation was set up in their community. The Virgin

Islands received their right to a separate system of taxation in 1922. The Congress then passed the Internal Revenue Code of 1922, excluding the Virgin Islands from exemption under the statutes on income received from possessions. Section 262-A of that Act reads:

> "That in the case of citizens of the United States or domestic corporation, satisfying the following conditions, gross income means only gross income from sources within the United States."

The term "United States" was defined in Section 2078 as:

> "The term 'United States' as used herein includes only the States, the territories of Alaska and Hawaii, and the District of Columbia."

It should be noted at this point that a specific distinction is thereby made between Alaska and Hawaii and Guam, which is included in the following paragraph, where it states:

> "The term 'possession of the United States', as used in Articles 1135, 1136, and this Article, includes Puerto Rico, the Philippine Islands, the Panama Canal Zone, Guam, Wake, and Palmira. It *does not include the Virgin Islands.*"

By this act, Guam was placed in a separate classification from Hawaii, Alaska, and the Virgin Islands. At that time it was in the same classification as Puerto Rico.

The history of the income tax law on the Island of Puerto Rico, too, becomes an important factor in

making a determination as to the status of Guam. The Internal Revenue Deperatment in Internal Revenue Cumulative Bulletin 1946-5-12254, I. T. 3788, stated, in construing the Revenue Code, at page 55, and after going over the historical facts of the entry of the Island of Guam into the Government of the United States as a possession:

> "In view of the foregoing (historical facts) it is held that citizens of Puerto Rico who are citizens of the United States * * * and who are not residents of the United States, are subject to Federal Income Tax *only* (italics added) upon income derived from sources within the United States in the same manner and subject to the same conditions as non-resident aliens."

Again in 1950, and at the same session of the Congress of the United States at which the Guamanian Organic Act was passed, an amendment was added to Section 251D, Internal Revenue Code, as follows:

> "As used in this Section, the term 'possession of the United States' does not include the Virgin Islands of the United States, *and such term when used with respect to citizens of the United States, does not include Puerto Rico.* (Amendment italicized 1950 Act, Section 221-A.)"

The Internal Revenue Department, in I. T. 4047, 1951-8-13571, makes a determination as to the meaning of this statute, and quotes the historical reasons as to why the income tax law was not previously applied in full to citizens of Puerto Rico, and now makes such application. Appellant respectfully asks this

Court and the appellee that if the Congress of the United States had not specifically recognized a distinction between Guam and the other possessions, then why did they not include Guam when adding Puerto Rico to the exclusion under Section 251D? It will be seen from the foregoing that insofar as income taxes are concerned, there has certainly been a major difference between Guam and the other U. S. possessions.

C. Appellee, on pages 12 through 17 of his brief, attempts to pass over lightly the cases quoted by the appellant by saying: (a) They are old. (b) The decisions are on different points, not on immunity. We are somewhat surprised at the implication that because the cases were old they were not of any value to this Court in making a determination. A careful reading of the cases and of our original quotations proves that the statements relative therein to the status of the territories and their relations to the Congress of the United States were necessary to the decision and not mere dicta. Such a reading will further indicate that characteristics of a sovereign are very particularly described therein and are certainly applicable to the facts at hand.

D. At the bottom of page 13, the appellee quotes a portion of Section 25B of the Organic Act, but he fails to quote the remainder of that section, which is as follows:

> "The President of the United States shall appoint a commission of seven persons, at least three of whom shall be residents of Guam, to survey the field of Federal Statutes and to make recom-

> mendations to the Congress of the United States, within twelve months after the date of the enactment of this act, as to which Statutes of the United States not applicable to Guam on such date shall be made applicable to Guam, and as to which Statutes of the United States applicable to Guam on such date shall be declared inapplicable."

This indicates without question that insofar as the laws of Guam are concerned, they are still in a state of flux and as yet the Government of Guam is not a sovereign power which can carry out a complete system of laws. This contrasts sharply with Section 3 of the Organic Act of Alaska (Act of August 24, 1912, c. 387, Sec. 20, 37 Stat. 518), which states:

> "Constitution and Laws of the United States extended—That the Constitution of the United States and all the laws thereof which are not locally inapplicable, shall have the same force and effect within the said territory as elsewhere in the United States."

E. The case of *Kawananakoa v. Polybank,* 205 U.S. 349, 27 S. Ct. 526, is cited by the appellee as being the leading authority on the proposition of immunity to suit. Mr. Justice Holmes in that case stated, as quoted by the appellee at page 19:

> "The doctrine is not confined to powers that are sovereign in the full sense of juridicial theory, but naturally is extended to those that, *in actual administration, originate and change at their will, the laws of contract and property, from which*

> *persons within the jurisdiction derive their rights.''*

Does the Government of Guam seriously contend that they have the right to ''originate and change at their will the laws of contract and property'', in view of the foregoing portion of the Act, which gives to a commission, appointed by the President of the United States, the right to determine what laws shall be applicable to the Island of Guam? We do not think that they can seriously so contend.

Discussing the aforesaid case and the general proposition of immunity of a sovereign, Mr. Justice Frankfurter stated in his dissent in the recent case (1943) of *Great Northern Life Insurance Co. v. Reed,* 322 U.S. 54, at page 59:

> ''Whether this immunity is an absolute survival of the monarchial privilege or is a manifestation merely of power, or rests on abstract logical grounds (see Kawananakoa v. Polybank), it undoubtedly runs counter to modern democratic notions of the moral responsibility of the State. Accordingly, Courts reflect a strong legislative momentum in their tendency to extend the legal responsibility of government, and to confirm Maitland's belief, expressed nearly 50 years ago, that 'it is a wholesome sight to see the Crown sued and answering for its tort' (3 Maitland Collected Papers, 263).''

F. In quoting the case of the *People of Puerto Rico v. Manuel Castillo,* 227 U.S. 270, on page 20 of their brief, appellee states:

> "It is not open to controversy that, aside from the existence of some exception, the government which the Organic Act established in Puerto Rico is of such nature as to come within the general rule exempting a government sovereign, etc."

Appellant contends that that decision was based upon the general assumption that there were exceptions and that the particular nature of the government in Puerto Rico was binding. We contend again, that those exceptions exist in this case; that the differences have been pointed out by your appellant; that their law is in a state of flux, having not as yet been determined by the Federal Commission; that none of the arguments or authorities cited by appellee are binding; that in truth and fact such substantial differences exist between Guam and other possessions that immunity to suit should not and cannot obtain.

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### II. ANSWER TO ARGUMENT IN REPLY TO POINT 3.

A. The appellee starts out this portion of his brief on page 24 by quoting the Organic Act, Sections 30 and 31, stating:

> "The effect of the foregoing sections clearly is to create a tax liability on Guam, with collections to accrue to the Government of Guam."

He states further:

> "Regardless of who collects the tax created by the Organic Act of Guam, it is imposed by the Federal Government, and is levied and collected in accordance with the Income Tax Laws of the United States."

The appellant fails to see, by any stretch of the imagination, how the aforesaid section can be construed to create a tax liability on Guam. As a matter of fact, in practice, the Government of Guam follows the thesis of the Department of Internal Revenue, when it stated in I. T. 4046 (supra) that a dual system of taxation exists on the Island of Guam as a result of these sections of the Organic Act. Appellant contends that far from being immaterial as to who collects the tax in question, a careful reading of the Internal Revenue Code will show that there are specific sections as to who can and shall collect income taxes, and provisions for methods of payment for taxpayers outside of a collection district. We further believe that it is very important as to whether the tax is collected by a properly authorized Collector of Internal Revenue, thus affording a taxpayer all his remedies and recourses in the event that he feels he has any cause for complaint, or whether it is collected by an irresponsible local official acting without statutory authorization.

B. Appellee states, at page 26:

"Clearly, a Federal Tax is involved."

That is begging the question. If this was purely a Federal Tax, then why would it be necessary for the Government of Guam to bring up the question of sovereign immunity at all? The appellant does not ask the Court to determine solely that a Federal Tax exists; that is admitted by all the parties; it is a part of I. T. 4046 (supra); is not at issue. We ask: "Does the Government of Guam have the right under the Organic Act, to collect a territorial tax?" Per-

haps, in our original complaint we may have asked for more than one relief. Are we to be precluded from a remedy by reason of such surplusage? That certainly is not in accord with the general rules of practice in the Federal Courts of the United States.

C. The appellee quotes the provisions of the Federal Declaratory Judgments Act, with reference to the exceptions in cases of Federal taxes. We have contended and do contend that what is involved here is the collection of a territorial tax by the Government of Guam. Surely the appellee cannot deny the right of this Circuit Court of Appeals, sitting as a Court of Equity, to make a decision on the problem. The case of *Smith v. Ames,* 169 U.S. 466, states, at pages 517-520, discussing the problem of enjoining enforcement of certain rates for transportation on the grounds that the statute prescribing them was repugnant to the Constitution of the United States:

> "Under the principles which in the Federal system distinguish cases in law from those in equity, the Circuit Court of the United States, sitting in equity, can make a comprehensive decree, covering the whole ground of controversy, and thus avoid the multiplicity of suits that would inevitably arise under the statute."

This is not a matter of mere labels, as indicated by the appellee on page 27, but a matter of right. The individuals concerned on the Island of Guam are, under Section 31 of the Organic Act, subjected to the Income Tax Laws of the United States. There is a Federal Income Tax Law applicable to them. Unless they meet certain conditions they must pay taxes to

the Tax Collector of the United States. In addition to that, however, the Government of Guam is attempting to collect a territorial tax. We submit that there is no such tax.

The appellee assumes, in quoting the case of *Filipowicz v. Rothensies,* 31 Federal Supplement 716, and a portion of RS-3224, that no suit could be maintained to restrain collection of the tax in question, and that by reason therefor, a declaratory judgment may not be obtained under Section 274-D of the Judicial Code. The appellee neglects to examine the exceptions noted in Section 272-A with reference to income tax assessments, collection and deficiency, where it is stated:

> "Notwithstanding the provisions of Section 3653-A, the making of such assessment or the beginning of such proceeding or restraint during the time such prohibition is in force may be enjoined by a proceeding in the proper court."

Certainly, if the laws of the Island of Guam were not in such a state of flux at the moment that the Courts cannot know what laws to apply, the above exceptions would be brought into play and in the proper case an injunction to restrain collection of the tax in question could be obtained. We submit, therefore, that a declaratory judgment is permissible under the circumstances.

In summary, it would seem that the situation simply is this: The Government of Guam says:

> "The Organic Act of Guam provides for Federal Income Taxes on Guam with the exceptions set

out in Section 251-d, so that Guamanians would not ordinarily pay Income Tax, if they met certain conditions. But in addition to that, the Act set up a dual system, so that we get the tax money we need for our budget."

The appellant says:

"But there isn't any language to set up such a dual system of taxation and the history of the other possessions in similar circumstances, such as the Virgin Islands, and Puerto Rico, indicates that they weren't taxed until specifically excluded from Section 251-d of the Internal Revenue Code."

The Government of Guam says:

"You heard our decision, and you can't sue us to refute it. We're a sovereign who can do no wrong."

We submit that every man is entitled to his day in Court; that it is for the Federal Court to make a determination whether Federal agencies can set themselves up as omnipotent entities and whether, by so doing, they become final authorities on the construction of the Statutes of the United States Congress.

Dated, February 11, 1952.

Respectfully submitted,

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